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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 968

WILLIAM C. HAY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

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Supreme Court of the United States

OCTOBER TERM, 1944.

No. .....

WILLIAM C. HAY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

William C. Hay, formerly a naturalized citizen of the United States, but now a repatriated British subject, by his counsel, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit, entered in the above cause on November 14, 1944, affirming a decision of the Tax Court of the United States.

Opinions Below.

The Tax Court's opinion [R. 53-76*] is reported at 2 T. C. 460. The opinion of the Circuit Court of Appeals [R. 374-384] is reported at 145 F. (2d) 1001.

*References such as this are to pages of the printed Transcript of Record. Italics supplied throughout unless otherwise indicated

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered November 14, 1944 [R. 385]. Petition for rehearing was denied January 3, 1945 [R. 415]. Jurisdiction is conferred on this Court under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

August 6, 1937, petitioner transferred all of the shares of a California corporation, costing $32,500, in exchange for all the shares of a Bahamas corporation, worth $2,491,583, without satisfying the Commissioner in the manner provided in Section 112(i) of the Revenue Act of 1936 [copied at R. 334].

December 10, 1937, the Bahamas Corporation surrendered all the shares of the California corporation in exchange for a general assignment of all of the latter's assets in complete liquidation.

Both exchanges took place in Nassau, where petitioner resided.

The questions presented are:

1. Whether Section 112(i) may be applied differently in the case of a nonresident alien than in the case of a citizen or resident alien. More specifically, the question is whether the gain on the August exchange, which would unquestionably be "recognized" *and taxed* to a citizen or resident alien, may be wholly disregarded and not "recognized" by the Commissioner or the courts in order to by-

pass and defeat Section 212(a), which prevents such gain from being taxed to a nonresident alien.*

2.** Whether gain on an exchange of stock for assets in complete liquidation is a "dividend" within the meaning of Section 119(a)(2), as the Circuit Court of Appeals held, or is gain from an "exchange" within the meaning of Section 119(a)(6), as petitioner contends.

3. Where the Commissioner determined and assessed the deficiency on the basis that petitioner was a citizen and was taxable on the August 6 gain, adhered to that position in his answer and throughout the trial, and twice expressly declined to amend his answer, was it due process of law for the Tax Court to sustain the deficiency upon the diametrically contradictory basis that petitioner realized gain on the December exchange and was taxable thereon as a nonresident alien engaged in business in the United States, the petitioner having prevailed on each of the three issues framed by the pleadings?

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*As shown by the 90-day letter [R. 8], elucidated by the 30-day letter [R. 11, 13, 15, 17, 18, 19—see reference to Sec. 112(i) on R. 19] and by the opinion of the Circuit Court of Appeals [R. 384], the Commissioner originally taxed the identical gain—on the August exchange—that he later sought to disregard if, but only if, the evidence showed that petitioner was a nonresident alien on August 6 and that the August exchange was consummated outside the United States. See also opinion of Tax Court rejecting the Commissioner's contention that the August exchange "should be regarded as having taken place in the United States * * *." [R. 67-68.]

**This question and question 3 disappear if Sec. 112(i) *requires* that the August 6 gain be "recognized." *Cf. Texas-Canadian Oil Corp., Ltd.*, 44 B. T. A. 913, at 918-919, squarely holding that Sec. 112(i) "cannot be ignored" by the Commissioner or the courts. This case was ignored by both courts below, although specifically called to their attention.

Statutes Involved.

The applicable statute is the Revenue Act of 1936, c. 690, 49 Stat. 1648. Most of the relevant sections of that Act were copied in Appendix A to respondent's brief in the Circuit Court of Appeals and may be found at R. 332-340. Others are copied in the Appendix, *infra*, pp. 21 to 23.

The applicable regulations are Regulations 94, some of the articles of which are copied at R. 340-349, others in the Appendix, *infra*, pp. 23 to 29.

Statement.*

This case involves income tax liability for the calendar year 1937. The pertinent findings are undisputed; the bulk of the printed record relates to the question of procedural due process.

Born a British subject in Canada, petitioner became a naturalized citizen of the United States in 1918. Exercising "a natural and inherent right of all people,"[1] petitioner expatriated himself on June 17, 1937, and simultaneously became repatriated as a British subject, entitled to the rights confirmed by the Naturalization Convention of 1870 between the United States and Great Britain,[2] and to the right to remove his property from the United States guaranteed by Article II of the Convention of 1899

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*No brief in support will be filed, but because of the length of both opinions below and the nature and importance of the several questions, this Statement will necessarily be somewhat extended (12 pages).

[1]See Sec. 800 of Title 8, U. S. C. A.—Right of Expatriation—copied in footnote 1 of opinion of Tax Court, R. 64; also at R. 331.

[2]16 Stat. 775, Malloy, Treaties, Conventions, etc. (1910), Vol. 1, pp. 691-693. Art. III provides that the United States will not claim a repatriated British subject "as a citizen of the United States on account of his former naturalization."

between the United States and Great Britain as to Tenure and Disposition of Real and Personal Property.[3]

More than ten years prior to 1937, petitioner acquired all the stock of William C. Hay, Ltd., a California corporation, at a cost of $32,500. Shortly after his repatriation in Canada on June 17, 1937, "petitioner proceeded to Los Angeles to wind up his *personal*[4] affairs, and, on July 21, 1937, he left Los Angeles for Nassau" [R. 57]. Arriving at Nassau July 26, 1937, with all the stock of Hay, Ltd. in his possession, petitioner immediately established residence there. August 4 a corporation named Colonial Trust Co., Ltd. was chartered under the laws of the Colony of the Bahamas and on August 6 all of the stock of Hay, Ltd. was transferred to Colonial in exchange for all its stock, which on that date had a value of $2,491,583 in United States dollars [R. 57-58].

Three months later, in November, petitioner became alarmed over the possibility that tax legislation would be enacted by Congress in 1938 aimed at surpluses of American corporations. [R. 59; *cf.* R. 66.] As a result, the Board of Directors of Hay, Ltd., meeting in Nassau on December 3, authorized the winding up and dissolution of that corporation and the distribution of its assets [R. 59]. This action was taken pursuant to a written consent executed by Colonial, as Hay, Ltd.'s stockholder [R. 59], under authority of Sec. 400 of the California Civil Code [copied at R. 104]. Under Sec. 400a [R. 105-106], the dissolution proceedings were subject to revocation *by Colonial* "at any time prior to distribution of the assets"

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[3]31 Stat. 1939, Malloy, Treaties, etc. (1910), Vol. 1, pp. 774-777.

[4]There is no finding of fact that petitioner engaged in trade or business or had an office or place of business in the United States during the taxable year *qua* nonresident alien; and such a finding, if made, would not be within the issues as framed by the pleadings [R. 1-4; R. 20].

by Hay, Ltd. Thus Hay, Ltd. retained the ownership of its assets until the very moment that, in Nassau on December 10 [R. 59], it executed and delivered the written assignment by which it "conveyed to Colonial * * * all its property" [R. 59-60]. Until that moment the dissolution proceedings created no tax consequences.[5] Under California law, "The assignment having been delivered in the [Colony of the Bahamas], the transaction took place in that State * * *."[6] Colonial still owned all these assets—and others—at the time of the hearing in 1942 [R. 60, 61].

Examining petitioner's 1937 tax return, the Commissioner determined that petitioner had realized a capital gain of $2,459,083 by reason of the August 6 exchange [R. 384]; that 30% of this amount was to be "taken into account" under Section 117 [R. 336]; and that there was a deficiency of $484,093.20 [R. 18-19]. This determination was necessarily bottomed on recognition by the Commissioner of the foreign corporation as an entity separate from petitioner, and necessarily excluded the idea of gain to petitioner *individually* from the December liquidation, from which he acquired exactly nothing. (There is no finding as to the value of the assets on December 10 and hence it cannot be determined whether *Colonial* realized gain or loss on *that* exchange.)

In his petition to the Tax Court [R. 1-5], petitioner did not challenge either the fact or amount of "recognized" gain but asserted that he was a nonresident alien on August 6, 1937; that the exchange of that date took place in Nassau; and that the profit constituted income from sources without the United States and could not,

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[5]*Cf. Wells Fargo Bank v. Blair*, 26 F. (2d) 532, 534 (C. A. D. C., 1928).

[6]*Balconades Ballroom, Inc. v. Superior Court*, 109 Cal. App. 612, 615 (1930) [R. 398, note 14].

therefore, be included in his gross income for the purpose of computation of his liability for United States income taxes [R. 384].

Respondent's answer [R. 20] put in issue petitioner's allegations that he was an alien, that he was a nonresident, and that the exchange of August 6 took place outside the United States. [The Tax Court eventually found in favor of petitioner on all three of these issues. R. 62; 66-67.] Neither the answer nor the deficiency notice made any claim that petitioner individually realized any gain from the liquidation of the California corporation in December.

Shortly before trial in 1942, the Commissioner made a jeopardy assessment of the deficiency, together with interest computed on the erroneous factual assumption that petitioner was a citizen, not a nonresident alien.[7] Throughout the entire trial [R. 142, 182, 211, 295], the Commissioner, consistently with the issues framed by the pleadings, contended that petitioner's "alleged expatriation" was fraudulent and that he was taxable—as a citizen unquestionably would be—on the undisputed gain of $2,459,083 realized from the exchange of August 6.

But while affirmatively declining [R. 168; 241] to amend his pleadings to frame a new issue, in the alternative or otherwise, the Commissioner *orally* contended, but only in the alternative, that petitioner individually realized a gain from the December 10 exchange, though concededly petitioner actually received no property whatever subsequent to August 6. This alternative was necessarily bottomed upon ignoring the Bahamas corporation as a separate entity and consequently excluded the idea that petitioner realized gain in August.

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[7]The Tax Court eventually gave petitioner judgment for $7,321.08, representing interest for the 92 days beginning March 15, 1938, for which a citizen or resident alien, but not a nonresident alien, would have been liable. [R. 79.]

Although this unpleaded alternative ground was diametrically contradictory of the basis of the Commissioner's deficiency determination, of the basis of the jeopardy assessment,[8] and of the Commissioner's position in his pleadings, the Tax Court, over petitioner's objections and in disregard of its own rules and decisions, permitted the Commissioner to pursue both contentions without amending his answer to set up the new matter.

The Tax Court found that petitioner "has been a nonresident alien of the United States at all times since June 17, 1937" [R. 62]. It held [R. 66-67] that—

> The gain on the original exchange of August 6, *viewed as a separate transaction,* would have been taxable to petitioner under the provisions of section 112(i) were it not for the fact that the exchange took place outside the United States * * * and is not taxable to petitioner, a nonresident alien. Sec. 212(a), *supra.* (Italics added.)

The Tax Court specifically rejected the Commissioner's argument that the August 6 "exchange should be regarded as having taken place in the United States" [R. 67].

But the Tax Court did not stop there, as it should have; it held, inconsistently, that petitioner realized "a large profit" from the December liquidation [R. 68] and that the "source" of this profit was within the United States [R. 73].

The decision thus comes down to this: Petitioner realized no gain on August 6, when he acquired new property worth $2,491,583 in exchange for property costing $32,500, but realized "a large profit" on a date on which he acquired no property whatever.

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[8]The Commissioner would not have assessed interest for the 92 days beginning March 15, 1938 [R. 63] unless he considered petitioner to be taxable as a citizen or resident alien.

The slightest analysis shows that this bizarre concept would not have been adopted had the Tax Court found that petitioner was a citizen on August 6, or that that exchange took place within the United States; that it was conceived and brought into being only as a way to defeat the mandate of Section 212(a), which is merely declaratory of the constitutional right of a nonresident alien to be free from tax on income from sources without the United States.

In *Texas-Canadian Oil Corp., Ltd.*, 44 B. T. A. 913 at 918-919, the Tax Court squarely held that Section 112(i) is not limited to citizens or residents. When that provision was first enacted (as Section 112(k) of the Act of 1932, 47 Stat. 169), there were substantial reasons why it should be applicable to nonresident aliens. All nonresident aliens were then liable for tax on all income from sources within the United States, including capital gains from sales or exchanges.[9] While Congress knew that a nonresident alien, by making an exchange of *personal* property with a foreign corporation outside the United States, could escape taxation on any gain therefrom, Section 119(a)(6), Congress doubtless also knew that Section 112(i) would result in a nonresident alien being taxable on "recognized" gain from an exchange of *real* property with a foreign corporation, as such a gain, under Section 119(a)(5) (*infra*, p. 21), is "income from sources within the United States" regardless of where the exchange takes place.

Sections 111, 112(a), 112(b)(5) and 112(i) draw no distinction whatever as between different classes of taxpayers and clearly should not be applied differently to a

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[9]It was not until the Act of 1936 that Congress provided that nonresident aliens not engaged in business and not having an office or place of business in the United States were to be taxed only on "fixed or determinable" income, which does not include capital gains.

nonresident alien than to a citizen or resident alien. It is only after the provisions of Sections 111 and 112 have first been applied to determine the realization and "recognition" of gain that it is permissible for the Commissioner or the courts to look to Sections 212(a) and 119 to determine whether the gain, though realized and "recognized," is includible in the gross income of a nonresident alien. The opinion of the Circuit Court of Appeals clearly shows that it violated this principle and thus wholly defeated the true import of Section 212(a).[10]

One of the reasons for filing this petition is the conviction that this Court will not permit an administrative official or the courts to ignore the unambiguous language of a specific statutory provision merely to defeat the rights of a friendly alien. Compare, by analogy to the by-passing herein of Section 212(a), *United States v. General Motors Corp.*, Jan. 8, 1945, 89 Law. Ed. Adv. Ops. 379 at 384.

The Solicitor General, with his usual candor, will doubtless concede that if a citizen or resident alien had made the August 6 exchange, and had died the very next day, he would be liable for tax on a "recognized" gain of $2,459,083 *even though the December exchange had never occurred.* This is so because, since Section 112(i) withdraws[11] nonrecognition of gain but preserves nonrecognition of loss, it necessarily applies to each exchange *separately* if there are two or more. If the August and December exchanges be viewed in combination, they would constitute a tax-free reorganization except for Section 112 (i). (*Cf. Whittell & Company, Inc.*, 34 B. T. A. 1070.) The Tax Court had no power to view the August

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[10]See especially the Court's footnote beginning R. 377, and particularly the last sentence thereof, R. 378.

[11]"Withdraws" is the terminology of Senate Rep. No. 655, 72nd Cong., 1st Sess. (1932 Act), 1939 Cum. Bull. (part 2), p. 515, copied in the Appendix, *infra*, p. 28.

and December exchanges otherwise than as separate transactions. As *Dobson v. Commissioner,* 320 U. S. 489, makes clear, "latitude" exists in the Tax Court in such matters only "Where no statute or regulation controls, * * *" (pp. 501-502). In the case at bar, Section 112(i) is a specific and controlling statute, and Article 112(i)-1 is a specific and controlling regulation. They broke up what in combination would have been a "reorganization" under Section 112(b)(3) and (g) [R. 333], and made two separate transactions, *each* of a taxable nature. This is nonetheless true where the taxpayer is a nonresident alien than where he is a citizen or resident alien.

Furthermore, there was gain on the August 6 exchange —realized that day—whether that exchange be viewed separately or not. Petitioner still owns the identical property he received August 6, and the December exchange neither added to, nor subtracted from, nor changed, that which petitioner got August 6.

The Circuit Court of Appeals introduced a new concept, namely, "that Hay made no *actual* profit from the exchange of August 6, 1937" [R. 378]. Obviously that fact—and the further fact, ignored below, that petitioner made "no actual profit" during 1937 at all—are utterly irrelevant under Sections 111 and 112. This is clearly shown by *Helvering v. Cement Investors, Inc.,* 316 U. S. 527, and particularly by a case cited with apparent approval in note 3 therein, *Insurance & Title Guarantee Co. v. Commissioner,* 36 F. (2d) 842 (C. C. A.-2, 1929).

Both courts below recognized that it was not enough merely to hold that petitioner realized a gain from the December liquidation exchange; there was no tax liability in any event if the "source" of that "gain" was outside the United States. Section 212(a). Under California law, which applies the *mobilia sequuntur* rule, the "source" would clearly be Nassau, not California. (*Robinson v.*

McColgan, 17 Cal. (2d) 423; *Miller v. McColgan,* 17 Cal. (2d) 432 (1941).) But the matter of "source" under the federal act is governed by the specific language of Section 119 [R. 336]. Two mutually exclusive subdivisions of that section are involved: Section 119(a)(2)—Dividends, and Section 119(a)(6)—Sale of Personal Property. By definition, Section 119(f) [R. 338], the word "sale" includes "exchange." Section 119(e) provides that "gain * * * derived from the purchase of *personal* property within and *its* sale without the United States * * *, shall be treated as derived entirely from sources within the country in which sold * * *" [R. 337].

The undisputed findings show that petitioner's foreign corporation, as the *owner* of the California shares, surrendered them *in Nassau* in exchange for a general assignment of assets executed by the California corporation in Nassau on December 10 [R. 59-60]. Under decisions construing Section 119, a sale or exchange takes place where title to the property passes. (*East Coast Oil Co.,* 31 B. T. A., 558, 561 (1934), affirmed, *Commissioner v. East Coast Oil Co.,* 85 F. (2d) 322 (C. C. A.-5, 1936), certiorari denied, 299 U. S. 608. *Cf. Compania General De Tabacos De Filipinas v. Collector,* 279 U. S. 306.)

There is a complete correlation between the *assessing* provisions of Section 211 [R. 338], the *withholding* provisions of Section 143(b) (*infra,* p. 22), and the *source* provisions of Section 119 [R. 336]. To say, as did the Circuit Court of Appeals [R. 382], that a distribution in liquidation is a "dividend" within Section 119(a)(2) is inescapably to say that it is a "dividend" within Section 211(a) [R. 338] and Section 115(a) [R. 334]. To say that it is a "dividend" within Section 211(a) is necessarily to say that it is a "dividend" within Section 143(b). To say that a distribution in liquidation is a "dividend" within Section 143(b) is to say that every corporation which makes a distribution in liquidation to a nonresident

alien, whether taxable under Section 211(a), or 211(b), must withhold the tax thereon.[12]

Yet we find that the Regulations have made it clear that a distribution in liquidation is not a "dividend" within the meaning of Sections 119(a)(2), 143(b) and 211(a); also that the term "dividends," as used in those sections, means precisely the same thing as "dividend" as defined in Section 115(a).

Art. 211-7(a) [R. 344] says: "As to the determination of fixed or determinable annual or periodical income see article 143-2. Art. 143-2 (*infra*, p. 26), defines "fixed or determinable annual or periodical income" as including "dividends," and Art. 143-1 (*infra*, p. 26), says: "For determining income from sources within the United States, see section 119." Art 119-3—Dividends, says: "Gross income from sources within the United States includes dividends, *as defined in section 115*" (*infra*, p. 24). The statutory definition of "dividend" is found in Section 115(a), and comparison with Section 115(c) shows clearly that a "dividend" does not include a distribution in liquidation. That is also the view of Art. 143-1 of the Regulations, which says:

> * * * The tax must be withheld at the source from the *gross* amount of any distribution made by a corporation *other than* * * * a distribution in partial or complete liquidation.

As a distribution in liquidation is not a "dividend" within Section 119(a)(2), it must necessarily involve an "exchange" within Section 119(a)(6). As the shares of Hay, Ltd., surrendered in exchange for that corporation's assets, were *personal* property, the source of the "gain," assuming there was any, was "the country in which sold." (Section 119(e).) The undisputed findings shows that this was in Nassau [R. 59-60].

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[12]See first sentence of Art. 143-1, Regs. 94, *infra*, p. 25.

Art. 143-2 also says that "The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income." This is extremely important, as nonresident aliens taxable under Section 211(a) are taxable *only* on "annual or periodical income"; since 1936 they have not been taxable at all on any capital gains. (*Cf. De Nobili Cigar Co.*, 1 T. C. 673 at 678, first paragraph.)

The Solicitor General will presumably concede that a nonresident alien not engaged in business in the United States is not taxable on a gain realized from a distribution in liquidation even if the exchange of his shares for assets actually takes place in the United States. But this is so because a distribution in liquidation is not a "dividend" within Sections 211(a), 143(b), 119(a)(2), or 115(a).

How, then, can the mere fact that the distributee is a nonresident alien engaged in business in the United States alter the *character* of a distribution in liquidation and convert it into a "dividend"? Such distributions are not "dividends" to citizens. (*Cf. Helvering v. Credit Alliance Corp.*, 316 U. S. 107 at 110.)

The Tax Court entered final judgment that petitioner owed the exact *tax* deficiency asserted in the deficiency notice. The Commissioner, however, had also assessed and collected interest in the amount of $132,853.74, calculated from March 15, 1938 [R. 63]—as interest would be calculated in the case of a citizen. Having found that petitioner was a nonresident alien, against whom interest began only on June 15, 1938 (Sections 292, 218 and 56), the Tax Court gave judgment in favor of petitioner for "an overpayment in interest on jeopardy assessment of $7,321.08," which was the amount of interest attributable to the 92 days beginning March 15, 1938 [R. 79].

The Circuit Court of Appeals properly took the view "that the deficiency seems to have been based on the August exchange" [R. 384]. But as the issues framed by the pleadings went only to the question whether the undisputed "recognized" gain of August 6 was taxable to petitioner or was excluded from gross income under Section 212(a), the court, in line with the last paragraph of *Helvering v. Cement Investors, Inc.*, 316 U. S. 527 at 535, should have refused to consider the December exchange even if Section 112(i) had not already made that exchange irrelevant to petitioner's tax liability. The framing of issues by written pleadings timely filed is of the essence of fair hearings. (*Cf. Dobson v. Commissioner*, 320 U. S. at 498.) That is recognized by the Tax Court's Rules 6, 14, 16, 17, 18 and 32, 26 U. S. C. A. "§3600 to End", p. 604, which rules are usually enforced. (*Cf. California Brewing Association*, 43 B. T. A. 721 at 725; *Commissioner v. Sussman*, 102 F. (2d) 919 at 922 (C. C. A.-2, 1939).) The petitioner won all three of the only issues framed by the *written* pleadings and yet stands defeated unless this Court exercises its discretionary powers.

With deference it is submitted that the opinions below contain as much "bad law" as it is possible to find in a single case. Both opinions show that the courts viewed it as a "hard case." That view ignores the fundamental elements of the *right* of expatriation—a right indispensable to the human freedom which this Court is ever zealous to defend. Aside from the right of the petitioner to have a corporation, organized under the laws of his own sovereign, own shares of United States corporations —and the undisputed findings show that Colonial owned shares of other corporations than Hay, Ltd. [R. 60]—Sections 212(a) and 119(e) presuppose that a nonresident alien has a *right* to consummate, tax-free, outside the United States, sales or exchanges of *personal* property that might be taxable if made within the United States.

Reasons Relied on for the Allowance of the Writ.

1. Never before has the Commissioner contended that he has the power to ignore a *gain*. (*Cf. Burnet v. Commonwealth Improvement Co.*, 287 U. S. 415.) Never before has he contended for the power to ignore a specific legislative command to "recognize" a *gain*. (*Cf. Texas-Canadian Oil Corp., Ltd.*, 44 B. T. A. 913.)

These contentions involve important questions of federal law which have not been but should be settled by this Court, especially when the claimed administrative power is desired only to defeat the rights of a nonresident and friendly alien specifically declared by Section 212(a) and probably having their roots in the limitations of the taxing power of Congress. (*Cf. United States v. Belmont*, 301 U. S. 324 at 332.)

2. The "no actual profit" concept introduced into the body of tax law by the opinion of the Circuit Court of Appeals [R. 378-379] is in direct conflict with the decision of the Second Circuit in *Insurance & Title Guarantee Co. v. Commissioner*, 36 F. (2d) 842, cited with approval in note 3 of the opinion of this Court in *Helvering v. Cement Investors, Inc.*, 316 U. S. 527, with the reasoning of which such concept is also completely out of harmony.

3. In affirming the decision of the Tax Court based upon a transaction of exchange entirely different from that upon which the deficiency was determined and assessed, and not within the issues as framed by the Commissioner (*cf.* last paragraph of *Helvering v. Cement Investors, Inc.*, 316 U. S. 527 at 535), the Circuit Court of Appeals so far departed from the accepted and usual

course of judicial proceedings, and so far sanctioned such a departure by the Tax Court, as to call for an exercise of this Court's power of supervision. In allowing the Commissioner to add "another string to his bow" (*cf.* last paragraph of *Helvering v. Wood,* 309 U. S. 344 at 349—and see R. 132), which he declined to plead and which was—factually and legally—diametrically contradictory of the basis of his deficiency determination, to which basis the Commissioner adhered throughout the trial, the Tax Court allowed an administrative official to act in a manner contrary to "the cherished judicial tradition embodying the basic concepts of fair play." (*Morgan v. United States,* 304 U. S. 1 at 22.)

4. In holding that a distribution in complete liquidation is a "dividend" within Section 119(a)(2), and not an "exchange" within Section 119(a)(6), (e) and (f)—as it is under Section 115(c)—the courts below have inescapably held that *all* nonresident aliens, including those taxable under Section 211(a), are taxable on distributions in liquidation. Section 211(a) aliens, ever since the enactment of the Revenue Act of 1936, have been taxable *only* on "fixed or determinable annual or periodical" income [R. 338-339] from "sources within the United States, determined under the provisions of section 119." (See Art. 211-7 and the cross-reference to Art. 143-2.) To protect the revenue in the case of nonresident aliens of all classes, all payors of "fixed or determinable" income, including "dividends," are required to withhold from the payment or distribution a tax at a specified rate. Section 143(b) (*infra,* p. 22); first sentence of Art. 143-1 (*infra,* p. 25). But the Treasury, beginning with Regulations 94 (1936) and continu-

ing to the present time, has consistently provided that "The tax must be withheld at the source from the gross amount of any distribution made by a corporation, *other than* * * * a distribution in partial or complete liquidation * * *." (Next to last sentence of first paragraph of Art. 143-1 (*infra*, p. 26).) This is the equivalent of saying that a distribution in liquidation is *not* a "dividend," which is completely consistent with the long-settled statutory concept of Section 115(c), that a distribution in liquidation involves an exchange. (*Cf. Hellmich v. Hellman*, 276 U. S. 233.)

Unless this Court corrects the view of the courts below that a distribution in liquidation is a "dividend," it will be necessary, notwithstanding Art. 143-1, for all corporations making such distributions to withhold the tax therefrom. Thus, Section 211(a) aliens, that is, those not engaged in business, will be subjected to a tax on the gross amount distributed to them (*cf. Neill*, 46 B. T. A. 197), even in cases where the cost of their shares surrendered is greater than the amount distributed and there is in fact no income.

The question on this branch of the case is, therefore, one of importance in the administration of the revenue acts which has not been but should be settled by this Court.[13]

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[13]The current 1945 rate is 30%. Secs. 211(a) and 143(b), I.R.C.

Conclusion.

For the foregoing reasons it is respectfully submitted that this petition should be granted.

JOSEPH D. BRADY,
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WALTER L. NOSSAMAN,
Of Counsel.

February 14, 1945.

Certificate of Counsel.

The undersigned counsel of record hereby certifies that the foregoing petition is well founded and is not interposed for the purpose of delay.

JOSEPH D. BRADY,
Attorney for Petitioner.

APPENDIX.

REVENUE ACT OF 1936, c. 690, 49 Stat. 1648:
TITLE I—INCOME TAX.

* * * * * * * * *

SUBTITLE C—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT B—COMPUTATION OF NET INCOME.

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

See printed Transcript of Record, p. 332.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

See printed Transcript of Record, p. 333.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

See printed Transcript of Record, p. 334.

SEC. 117. CAPITAL GAINS AND LOSSES.

See printed Transcript of Record, p. 336.

SEC. 119. INCOME FROM SOURCES WITHIN UNITED STATES.

For Sections 119(a)(2), 119(a)(6), 119(e) and 119(f), see printed Transcript of Record, pp. 336-338.

Section 119(a)(5), not contained in the printed record, reads as follows:

(a) *Gross Income from Sources in United States.*—The following items of gross income shall be treated as income from sources within the United States:

(5) Sale of Real Property.—Gains, profits, and income from the sale of real property located in the United States.

SUPPLEMENT D—RETURNS AND PAYMENT OF TAX.

SEC. 143. WITHHOLDING OF TAX AT SOURCE.

(b) *Nonresident Aliens.*—All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment of interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (but only to the extent that any of the above items constitutes gross income from sources within the United States), of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, shall (except in the cases provided for in subsection (a) of this section and except as otherwise provided in regulations prescribed by the Commissioner under section 215) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 10 per centum thereof, except that such rate shall be reduced, in the case of a nonresident alien individual a resident of a contiguous country, to such rate (not less than 5 per centum) as may be provided by treaty with such country: *Provided,* That no such deduction or withholding shall be required in the case of dividends paid by a foreign corporation unless (1) such corporation is engaged in trade or business within the United States or has an office or place of business therein, and (2) more than 85 per centum of the gross income of such corporation for the three-year period ending with the close of its taxable year pre-

ceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119: *Provided further,* That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent. Under regulations prescribed by the Commissioner, with the approval of the Secretary, there may be exempted from such deduction and withholding the compensation for personal services of nonresident alien individuals who enter and leave the United States at frequent intervals.

SUPPLEMENT H—NONRESIDENT ALIEN INDIVIDUALS.

SEC. 211. [As amended by Section 501(a), Revenue Act of 1937, c. 815, 50 Stat. 813.] TAX ON NONRESIDENT ALIEN INDIVIDUALS.

See printed Transcript of Record, p. 338.

SEC. 212. GROSS INCOME.

See printed Transcript of Record, p. 339.

SEC. 217. RETURNS.

See printed Transcript of Record, p. 340.

TREASURY REGULATIONS 94, PROMULGATED UNDER THE REVENUE ACT OF 1936:

Art. 112(i)-1. Reorganization with or transfer of property to a foreign corporation.—

See printed Transcript of Record, p. 340.

Art. 115-5. Distribution in liquidation.—

See printed Transcript of Record, p. 341.

Art. 117-2. Limitations on capital gains and capital losses.—

See printed Transcript of Record, p. 342.

Art. 119-1. Income from sources within the United States.—Nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 251 are taxable only upon income from sources within the United States.
* * *

The Act divides the income of such taxpayers into three classes:

(1) Income which is derived in full from sources within the United States;

(2) Income which is derived in full from sources without the United States; and

(3) Income which is derived partly from sources within and partly from sources without the United States.

The taxable income from sources within the United States includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned to sources within the United States.

Art. 119-2. Interest.— * * *

Art. 119-3. Dividends.—Gross income from sources within the United States includes dividends, *as defined by section 115:*

(a) From a domestic corporation other than one entitled to the benefits of section 251, and other than a corporation less than 20 percent of the gross income of which is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of section 119, for the 3-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence); or

* * * * * * * * *

Art. 119-8. Sale of personal property.—Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold, * * *. The word "sold" includes "exchanged." The "country in which sold" ordinarily means the place where the property is marketed. This article does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States. (See article 119-12.)

Art. 143-1. Withholding Tax at Source.—(a) *Withholding in general.*—Withholding of a tax of 10 per cent is required in the case of fixed or determinable annual or periodical income paid to a nonresident alien individual *(even though such individual is engaged in trade or business within the United States or has an office or place of business therein)* or to a nonresident partnership, composed in whole or in part of nonresident alien individuals, except (1) income from sources without the United States, including interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having any office or place of business therein, (2) interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934 (but see paragraph (b) of this article) (3) dividends paid by a foreign corporation unless (A) such corporation is engaged in trade or business within the United States or has an office or place of business therein, and (B) more than 85 percent of the gross income of such corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States, as determined under the provisions of section 119, (4) dividends

distributed by a corporation organized under the China Trade Act, 1922, to a resident of China, and (5) except that such rate of 10 percent shall be reduced, in the case of a resident of a contiguous country, to such rate, not less than 5 percent, as may be provided by treaty with such country. *The tax must be withheld at the source from the gross amount of any distribution made by a corporation, other than a nontaxable distribution payable in stock or stock rights, or a distribution in partial or complete liquidation, without regard to any claim that all or a portion of such distribution is not taxable.* Appropriate adjustments, if any, will be made upon the filing of claims for refund.

* * * * * * * * *

For determining income from sources within the United States, see section 119.

* * * * * * * * *

Art. 143-2. Fixed or Determinable Annual or Periodical Income.—Only fixed or determinable annual or periodical income is subject to withholding. The Act specifically includes in such income, interest, *dividends*, rent, salaries, wages, premiums, annuities, compensations, remunerations and emoluments. But other kinds of income are included, as, for instance, royalties.

Income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be paid annually if it is paid periodically; that is to say, from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accordance with someone's will or with the happening of an event does not make the payments any the less determinable or periodical. A salesman working by the month for a commission on

sales which is paid or credited monthly receives determinable periodical income. The share of the income of an estate or trust from sources within the United States which is distributable, whether distributed or not, or which has been paid or credited during the taxable year to a nonresident alien beneficiary of such estate or trust constitutes fixed or determinable annual or periodical income within the meaning of section 143(b). *The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income.* Such items as taxes, interest on mortgages, or premiums on insurance paid to or for the account of a nonresident alien landlord by a tenant, pursuant to the terms of the lease, constitute fixed or determinable annual or periodical income.

LEGISLATIVE HISTORY OF SECTION 112(i), 1936 ACT.

From Senate Rep. No. 665, 72nd Cong., 1st Sess., 1932 Act, 1939-1 Cum. Bull. (Part 2), p. 515:

SECTION 112(k). *Transfers to Foreign Corporations.*

Property may be transferred to foreign corporations without recognition of gain under the *exchange and* reorganization sections of the existing law. This constitutes a *serious loophole for avoidance* of taxes. Taxpayers having *large unrealized* profits in securities may transfer such securities to corporations organized in countries imposing no tax upon the sale of capital assets. Then, by subsequent sale of these assets in the foreign country, the entire tax upon the capital gain is avoided. *For example,* A, *an American* citizen, owns 100,000 shares of stock in Corporation X, which originally cost him $1,000,000 but now has a market value of $10,000,000. Instead of selling the stock outright A organizes a corporation under the laws of Canada to which he transfers the 100,000 shares of stock in exchange for the entire capital stock of the Cana-

dian company. This transaction is a nontaxable exchange. The Canadian corporation sells the stock of Corporation X for $10,000,000 in cash. The latter transaction is exempt from tax under the Canadian law and is not taxable as United States income under the present law. The Canadian corporation organizes Corporation Y under the laws of the United States and transfers the $10,000,000 cash received upon the sale of Corporation X's stock in exchange for the entire capital stock of Y. The Canadian corporation then distributes the stock of Y to A in connection with a reorganization. By this *series* of transactions, A has had the stock of X converted into cash and now has it in complete control.

While it is probable that the courts will not hold all transactions of this nature to be tax-free exchanges, the committee is convinced that the existing law may afford opportunity for substantial tax avoidance. *To prevent this avoidance* the bill *withdraws* the transaction from the operation of the nonrecognition sections where a *foreign* corporation is a party to the transaction, *unless prior* to the exchange the Commissioner is satisfied that the transaction is not in pursuance of a plan having as one of its principal purposes the avoidance of taxes. It will be noted that under this provision a taxpayer acting in good faith can ascertain prior to the transaction, by submitting his plan to the Commissioner, that it will not be *taxable* if carried out in accordance with the plan. Of course, if the reorganization or the transfer is not carried out in accordance with the plan submitted the Commissioner's approval will not render the transaction tax-free.

This subsection provides for the *full recognition of gain* from any transaction described in any of the designated subsections (b)(3), (4), and (5), (d), (g), and so much of (c) as refers to (b)(3) and (5), involving a *foreign* corporation or the stock *or securities* thereof. That is, the

entire amount of *gain* will be *recognized* upon any transfer of property to or by a foreign corporation, any exchange of stock or securities for stock or securities of a *foreign* corporation or vice versa, or any *distribution* by *or to,* or *of the stock or securities of,* a *foreign* corporation, unless *prior* to the transaction the Commissioner is satisfied that it is not in pursuance of a plan having as one of its principal purposes the avoidance of taxes. For *all other purposes,* including the *non*-recognition of *loss* in any transaction described in the foregoing subsections, the tax status of a foreign corporation is not affected by the new subsection.

Another aspect of this same problem is discussed later in this report in connection with Title VII.

Service of the within and receipt of a copy thereof is hereby admitted this.....day of February, A. D. 1945.

2-16-45—65

SUPREME COURT, U.S.
FILED
AUG 17 1945
CHARLES ELMORE CROPLEY
CLERK

No. 968

In the Supreme Court of the United States

OCTOBER TERM, 1945

WILLIAM G. HAY, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT

BRIEF FOR THE [illegible]

No. 968

In the Supreme Court of the United States

October Term, 1938

[redacted]

[redacted]

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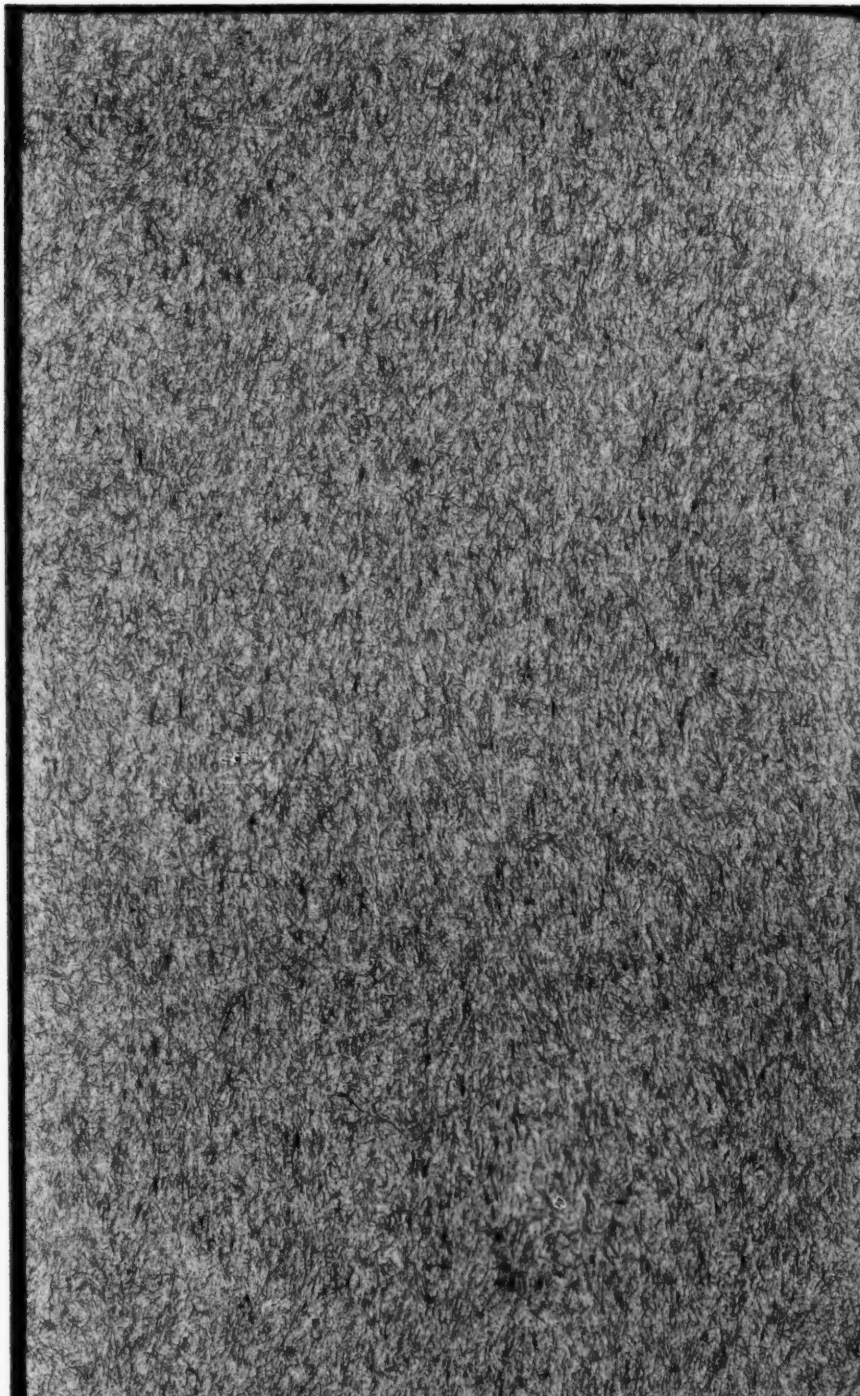

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 968

WILLIAM C. HAY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 53–76) is reported at 2 T. C. 460. The opinion of the Circuit Court of Appeals (R. 374–384) is reported at 145 F. 2d 1001.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 14, 1944 (R. 385), and a petition for rehearing was denied on January 3, 1945 (R. 415). The petition for a writ of certiorari was filed on February 21, 1945. The juris-

diction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether taxpayer realized a taxable gain upon the liquidation of William C. Hay, Ltd., a California corporation, in December, 1937.

2. Whether, in view of the scope of the pleadings, the Tax Court's consideration of the December 1937 liquidation prejudiced the taxpayer.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are contained in the Appendix, *infra,* pp. 21–28.

STATEMENT

The facts as found by the Tax Court (R. 54–63) may be summarized as follows:

Taxpayer was born in Canada in 1884 but, in 1911, left Canada and took up his residence in Los Angeles, California. In 1918 he became a naturalized citizen of the United States. (R. 54.)

Taxpayer was the sole stockholder of William C. Hay, Ltd., a California corporation, hereinafter referred to as Hay, Ltd. His stock cost him $32,500. (R. 55, 63.) The corporation was his personal corporation and represented the bulk of his wealth. Its assets, worth in excess of $2,000,000 in 1937, the tax year, were kept in a liquid condition. (R. 55.)

Over a period of years prior to 1937 taxpayer became very concerned over the trend of events in the United States, economically and politically, and developed an acute tax consciousness. Being confined to his bed frequently by reason of a lung condition which he had acquired in his youth, he became particularly alarmed over the death duties his estate would have to pay if he were to die a citizen or resident of this country. To meet the heavy estate taxes, taxpayer feared it would be necessary for Hay, Ltd. to declare dividends upon which, in taxpayer's view, his estate would be subjected to income tax. The combination of these two taxes, taxpayer thought, would probably wipe out the bulk of his estate. Consequently, by the beginning of 1936 taxpayer had decided to expatriate himself and resume his Canadian citizenship. Other considerations played a part in this determination, one of them being an unhappy domestic situation from which he desired escape. But taxpayer's desire to be free of estate taxes in this country was the primary reason for his expatriation. (R. 54–56.)

In the spring of 1936, taxpayer conferred in Los Angeles with one Thompson, an accountant who was an income tax specialist of Vancouver, British Columbia, and placed himself in the latter's hands with respect to working out the details of transferring his residence, citizenship, and property interests. Various places were suggested by

Thompson, one of them being Nassau, and in the fall of 1936 taxpayer made a visit to Nassau and decided to set up a home there. Thompson advised him to form a corporation wherever he decided to establish his residence, and consequently it was determined to organize a Nassau corporation. Nassau had no income tax and the death duties were negligible. A plan was worked out by taxpayer and Thompson whereby taxpayer was to form a corporation in Nassau, exchange his Hay, Ltd. stock in Nassau for all the shares of the Nassau corporation, and eventually have the Nassau corporation liquidate Hay, Ltd. None of these transactions was to take place until after taxpayer's expatriation. (R. 56.)

In 1936 taxpayer entered Canada and took up residence there. On June 17, 1937, he became a British subject and has remained a British subject at all times since that date. (R. 56–57.)

Shortly thereafter taxpayer proceeded to Los Angeles to wind up his personal affairs, and, on July 21, 1937, he left Los Angeles for Nassau. With Thompson, he arrived in Nassau on July 26, 1937, having in his possession all the stock of Hay, Ltd. Immediately upon arrival, taxpayer and Thompson contacted a Nassau attorney and requested him to proceed with the organization of a Nassau corporation. Taxpayer also acquired a lease on some living quarters for a period of one year. (R. 57.)

On August 2, 1937, before the new corporation was formed, illness in his family caused taxpayer to leave Nassau and go to Canada. Before leaving, he endorsed his Hay, Ltd. shares and appointed Thompson his attorney in fact, with instructions to deliver the shares to the new corporation upon receipt of its stock. Taxpayer remained in Canada from August 4, 1937, until the latter part of September, 1937. He then left Canada, stopping in New York for a few days, and arrived in Nassau about October 10, 1937. He remained in Nassau until the end of April, 1938, when he returned to Canada. (R. 57.)

The Nassau corporation was chartered in the Colony of the Bahamas on August 4, 1937, under the name of Colonial Trust Company, Ltd. On August 6, 1937, the Hay, Ltd. stock was transferred by taxpayer, through Thompson, to the Colonial Company in exchange for all of its stock. The assets of Hay, Ltd. consisted, at this time, of approximately $2,000,000 in cash in United States and Canadian banks, a few receivables, and some oil and real estate properties. The total stock of Colonial consisted of 5,000 shares of 100 pounds each, or a total of 500,000 pounds. The value of 500,000 pounds in United States dollars on August 6, 1937, was $2,491,583. (R. 57–58.) Taxpayer did not comply with Section 112 (i) of the Revenue Act of 1936 when he formed the Colonial Company in Nassau, and he did not advise the

Commissioner of the formation of the company before it was chartered and before leaving this country. (R. 63.)

After his return to Nassau in October, 1937, taxpayer decided to transfer the oil and real estate properties to a separate corporation under the management of his son, James, who was then about 26 years of age, to afford the latter some business experience (R. 58). About November 15, 1937 (R. 58, 63), taxpayer telephoned Thompson requesting him to have the attorneys of Hay, Ltd. in Los Angeles organize a California corporation for this purpose. Such a company was organized under the name of Beverly Oil Company on November 18, 1937, and the properties mentioned were transferred to it by Hay, Ltd. in exchange for its capital stock. During the telephone conversation referred to above, taxpayer requested Thompson to have the Hay, Ltd. attorneys prepare papers which could be used for the dissolution and liquidation of Hay, Ltd. When these papers had been prepared Thompson took them by plane from Los Angeles to Nassau. (R. 58.)

During the first week of November, 1937, taxpayer had as his guest in Nassau a New York economist, who called taxpayer's attention to discussions taking place in respect of proposed tax legislation to be enacted by Congress in 1938 taxing surpluses of American corporations, particularly holding companies. Taxpayer became

very much alarmed over such possibilities, and the question of liquidating Hay, Ltd. was discussed in Nassau during November. By November 27, 1937, taxpayer had decided to liquidate Hay, Ltd. Thompson was opposed to the liquidation in 1937, for he believed that this would result in tying together as one plan the August exchange of Hay, Ltd. shares and the subsequent liquidation. He considered that he had completed the job for which he had been engaged when the August exchange took place, for in his opinion that transaction had established the situs of taxpayer's wealth outside of the United States. (R. 59.)

The owners of the Hay, Ltd. stock (Colonial Trust Company, Ltd. and its secretary, the latter being the record holder of two shares of Hay, Ltd. stock) filed a written consent to the winding up and dissolution, as required by California law, and the board of directors, meeting in Nassau on December 3, 1937, authorized the winding up and dissolution, the taking of all necessary steps to that end, and the distribution of its assets. On December 10, 1937, a written instrument was executed in Nassau in the name of Hay, Ltd. by taxpayer, president, and the Nassau attorney, as assistant secretary, by which Hay, Ltd. conveyed to Colonial Trust Company, Ltd. all of its property. On that date, Hay, Ltd. had $1,190,859.74 in cash in Canadian banks and $875,400.33 in

United States banks. Its only other properties were the shares of Beverly Oil Company and 2,000 shares of Lancaster Process Company. Shortly after the liquidation, certificates for these shares were reissued in the name of Colonial, and these shares were still owned by Colonial at the time of the hearing herein. Checks for the cash in the aggregate amount of $2,066,260.07, were drawn to the order of the Colonial Trust Company, Ltd. and signed by taxpayer on December 10, 1937, while he was in Nassau. These were then mailed to the Bank of Nova Scotia in Montreal and deposited by that bank to the credit of Colonial Trust Company, Ltd. (R. 59–60.)

When taxpayer was in Montreal, Canada, in August and September, 1937, he opened two bank accounts with the Bank of Nova Scotia in that city in the name of Colonial Trust Company, Ltd. The first account, a Canadian dollar account, was opened on August 10, 1937, with a deposit of $80,000, which represented a loan by taxpayer to Colonial. The other was a United States dollar account and was opened on September 7, 1937, with a deposit of $50,000. On December 13, 1937, a total of $2,061,517.14 was deposited in this account, representing a portion of the checks drawn by Hay, Ltd., in liquidation, to Colonial. The balance of the liquidating cash distribution, $4,742.93, was deposited in the Canadian dollar account. Twelve other deposits aggregating $7,208.62 were

made in the United States dollar account during 1938 and 1939. (R. 60–61.)

Otherwise than as set forth herein, Colonial Trust Company, Ltd. has never engaged in any business since its formation. The only offices it had in Nassau were an office in the office of the Nassau attorney who assisted in the incorporation, and a room in an apartment that taxpayer maintained in Nassau while he was there. Colonial Trust Company, Ltd. has never had any paid employees. It has never had a bank account in any substantial amount in Nassau. All of its cash at the time of hearing herein was in Canada. Its minutes and other corporate documents are kept in taxpayer's home in Canada. Taxpayer has not been in Nassau since December, 1939. (R. 61.)

The Colonial Trust Trust Company, Ltd. was incorporated for the primary purpose of removing the situs of taxpayer's wealth from the United States with a view to avoiding estate taxes in the United States, and for the further purpose of accomplishing such removal in a manner that would produce no income tax liability. It had no business purpose. (R. 61–62.)

Since leaving the United States on July 26, 1937, taxpayer has not been in the United States for other than a temporary or transitory purpose. He has been a nonresident alien of the United States at all times since June 17, 1937. (R. 62.)

In his notice of deficiency and attached statement (R. 5–9), the Commissioner notified the taxpayer of a deficiency in his income tax. The proposed adjustment was explained, so far as here relevant, as follows (R. 8, 53–54):

> (b) Gain on disposition of capital stock of William C. Hay, Limited, is determined in the amount of $2,459,083.00. Inasmuch as the assets had been held for over ten years, 30 percent of that gain, $737,724.90, constitutes the portion thereof taxable as capital net gain under the provisions of sections 112 and 117 of the Revenue Act of 1936.

On these facts the Tax Court held that upon the liquidation of Hay, Ltd., in December, 1937, taxpayer realized gain from sources within the United States in the amount of the difference between the cost of his stock in the corporation and the value of its assets at the time of liquidation and, accordingly, that he was taxable on that gain (R. 64–73). The Tax Court also rejected the taxpayer's contention that the trial should be limited to a consideration of the events of August 6, 1937 (*supra*, p. 5), and that the liquidation of December 10 was not within its proper scope (R. 73–76). On appeal, the decision of the Tax Court was affirmed on both points (R. 374–384).

ARGUMENT

1. This case raises a question as to what tax effect is to be given to interlocutory steps in

pursuance of a tax avoidance scheme. Taxpayer was the sole stockholder of Hay, Ltd. and had acquired his stock at a cost of $32,500 (R. 55, 63). In 1937 the corporation had assets in excess of $2,000,000, including $2,000,000 in cash (R. 58). Becoming alarmed over the amount of estate and income tax his estate would be required to pay on this corporate property after his death, taxpayer, with the aid of a Canadian tax expert, worked out a plan to expatriate himself and transfer the property to Nassau in the Bahama Islands (R. 55–56). In order to accomplish his purposes it was necessary for him to rid himself of his stock in Hay, Ltd. since his estate would have been taxed on it upon his death even if he were a nonresident alien. Internal Revenue Code, Sec. 862 (a) (26 U. S. C. 862). However, if he were to rid himself of the stock by liquidating Hay, Ltd. he would be subjected to a large income tax. His plan (R. 56), therefore, was—

> to form a corporation in Nassau, exchange his Hay, Ltd., stock in Nassau for all the shares of the Nassau corporation, and eventually the Nassau corporation would liquidate Hay, Ltd. None of these transactions was to take place until after petitioner's expatriation.

Taxpayer executed this plan by securing his expatriation on June 17, 1937 (R. 56–57); chartering a Nassau corporation, Colonial Trust Company, Ltd., on August 4, 1937 (R. 57–58),

which had no business purpose (R. 61–62); transferring his Hay, Ltd. stock to Colonial Trust Company, Ltd. in exchange for all of its stock, on August 6, 1937, at Nassau (R. 58); and liquidating Hay, Ltd., on December 10, 1937, by transferring all of its assets to Colonial Trust Company, Ltd. (R. 59–60). Taxpayer now contends that this scheme, under which he used a foreign corporation as a mere "contrivance" to his above-described end (*Gregory* v. *Helvering*, 293 U. S. 465, 469), made his gain from the liquidation of Hay, Ltd., the California corporation, tax free.

The plan executed by taxpayer was one predicated principally upon Sections 112 (i) and 119 (e) of the Revenue Act of 1936 (Appendix, *infra*, pp. 22–23, 25). Under Section 112 (b) (5) and (i) (Appendix, *infra*, pp. 22–23) no gain would be recognizable from taxpayer's August, 1937, exchange of his Hay, Ltd. stock for all of the stock of Colonial Trust Company, Ltd., the Nassau corporation, if he established to the satisfaction of the Commissioner that the exchange was not in furtherance of a scheme for the avoidance of income taxes.[1]

[1] Section 112 (b) (5) provides that no gain shall be recognized when property is transferred to a corporation by a person in exchange for the stock of the corporation and immediately after the exchange such person is in control of the corporation. Section 112 (i), however, provides that a foreign corporation shall not be considered as a corporation under Section 112 (b) (5) unless it has been established to the satisfaction of the Commissioner that the exchange was not in pursuance of a plan for the avoidance of income taxes.

He did not attempt to do so. Hence, he argues that his gain was derived from this exchange, was recognizable because of his failure to satisfy the Commissioner that the exchange was not in furtherance of a scheme for tax avoidance, but that the gain was nontaxable under Section 119 (e) (Pet. 9–14). The latter Section provides, among other things, that gains, profits and income derived from the purchase of personal property within, and its sale, or exchange (Section 119 (f), Appendix, *infra*, p. 25), without the United States shall be treated as derived entirely from sources within the country in which sold or exchanged. As stated, taxpayer, as part of his plan, exchanged his Hay, Ltd. stock in Nassau for stock of the Nassau corporation. Thus, the gain to him would be derived from sources without the United States and nontaxable to him if, as he contends, the August exchange must be given effect as an isolated transaction. Both the Tax Court and the court below, however, correctly refused to give such effect to that exchange.

Contrary to taxpayer's repeated intimations (Pet. 9–12), the court below did not discriminate between United States citizens and nonresident aliens when it rejected his contention that his gain was derived from the August, 1937, exchange. The court simply applied the well-established rule that the existence of a corporation may be disregarded or ignored for tax purposes when it is

a sham set up for purposes of tax avoidance. *Higgins* v. *Smith*, 308 U. S. 473, 475–477; *Moline Properties* v. *Commissioner*, 319 U. S. 436, 439; *Commissioner* v. *Smith*, 136 F. 2d 556 (C. C. A. 2d); see also *Gregory* v. *Helvering*, 293 U. S. 465; *Griffiths* v. *Commissioner*, 308 U. S. 355, 357–358. The rule is clearly applicable here since, as the Tax Court found (R. 61–62), the Nassau corporation—

> was incorporated for the primary purpose of removing the situs of petitioner's wealth from the United States with a view to avoiding estate taxes in the United States, and for the further purpose of accomplishing such removal in a manner that would produce no income tax liability. It had no business purpose.

Accordingly, whatever the Nassau corporation did must be deemed to have been done by taxpayer. When he exchanged his Hay, Ltd. stock for the Nassau corporation stock, he made an exchange with himself which had no substantive effect; the transaction was a mere formality. The Commissioner was not bound to assess a tax on this transaction under Section 112 (i) and, in that way, aid in the consummation of taxpayer's plan for tax avoidance which Congress, in Section 112 (i) itself, intended to forestall. Thus when the Nassau corporation liquidated Hay, Ltd. the taxable effect was the same as if taxpayer himself had received the assets of the California corporation in liquida-

tion; the transaction resulted in the receipt by him of a large gain in the form of a liquidating dividend.[2]

Taxpayer is therefore liable for income tax on the gain he received from the liquidation of Hay, Ltd. if the gain was derived from sources within the United States (Section 212 (a), Appendix, *infra*, pp. 27–28).[3] Section 119 (Appendix, *infra*,

[2] Since the corporate existence of the Nassau corporation may be disregarded, there was no gain to taxpayer from the August, 1937, exchange of stock, either actual or otherwise, and taxpayer is incorrect in asserting (Pet. 16), as a reason for the granting of a writ of certiorari, that the Commissioner ignored a gain and that the court below introduced a new concept into the body of tax law by stating (R. 378) that taxpayer derived no actual profit from the August, 1937, exchange of stock. Nor is the decision below in conflict with *Insurance & Title Guarantee Co.* v. *Commissioner*, 36 F. 2d 842 (C. C. A. 2d), certiorari denied, 281 U. S. 748, as taxpayer asserts. That was simply a case in which the transaction was found not to fall within the exempting provisions applicable to reorganizations. Here the transaction does fall within those provisions and a gain is recognized under Section 112 (j) only to prevent tax avoidance.

[3] The case presents no question as to whether the gain was a fixed or determinable annual or periodical gain, profit or income within the meaning of Section 211 (a) (Appendix, *infra*, pp. 26–27). Nonresident alien individuals *not* engaged in trade or business in the United States are taxable only on such income, but subsection (b) of Section 211 (Appendix, *infra*, p. 27) provides that a nonresident alien is taxable without regard to subsection (a) if he is engaged in trade or business in the United States. Taxpayer does not (Pet. 14), and could not, contend that he was not engaged in trade or business in the United States during the taxable year. The

pp. 24–26) defines income from sources within and without, as well as from partly within and partly without, the United States. Dividends from domestic corporations are included under subsection (a) (2) (Appendix, *infra,* pp. 24–25) as from sources within the United States. But although liquidating dividends, to the extent that they are distributions of earnings and profits accumulated after February 28, 1913, come within the definition of a "dividend" contained in Section 115 (a) (Appendix, *infra,* p. 23), Section 115 (c) (Appendix, *infra,* pp. 23–24) provides that distributions in complete liquidation of a corporation shall be treated as in full payment in exchange for stock and that Sections 111 and 112 shall be applied in determining the recognizable gain. See *Hellmich* v. *Hellman,* 276 U. S. 233; *Helvering* v. *Credit Alliance Co.,* 316 U. S. 107, 110.

Taxpayer seeks to take advantage of this tax treatment of liquidating dividends, contending that the liquidation of Hay, Ltd. was a sale or exchange within the meaning of subsection (e) of

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phrase "engaged in trade or business within the United States" is defined in subsection (b) to include "the performance of personal services within the United States at any time within the taxable year." Taxpayer received a salary of $10,500 for his services as president and treasurer of Hay, Ltd., the California corporation, during the first seven months of 1937, the taxable year. He also was a citizen of the United States until June 17, 1937, lived in California until sometime in May of 1937, and returned to California after his expatriation for approximately a month.

Section 119, which provides that the source of gain from personal property purchased within the United States and sold (which includes "exchanged" pursuant to subsection (f)) without the United States, as well as from personal property purchased outside the United States, and sold in the United States, shall be the country "in which sold". It is at once apparent that the liquidation alone does not satisfy this provision, for subsection (e) contemplates two separate transactions—the purchase and subsequent sale of the same property by one person, not a simultaneous purchase by one person and sale by another. Assuming that taxpayer's purchase of his Hay, Ltd. stock in this country and its subsequent "sale" to Hay, Ltd. in liquidation may be considered two transactions for the purposes of subsection (e), even though a liquidation is the unilateral act of a corporation, not a sale or exchange in the commonly accepted meaning of those terms, it does not follow that taxpayer "sold" his Hay, Ltd. stock outside the United States. He "sold" the stock to Hay, Ltd., a domestic corporation which was incorporated under the laws of California, was engaged in business in California, conducted all of its business in the United States, and had no outside agency. Hence he "sold" the stock in the United States, regardless of the country in which he surrendered the stock certificates or from what country they

were forwarded to Hay, Ltd. The United States was the country in which he "marketed" the stock—the controlling factor under the Treasury's interpretation of subsection (e). See Treasury Regulations 94, Article 119–8 (Appendix, *infra*, p. 28). In other words, Congress did not intend to provide that one liquidating dividend might have numerous sources, the number depending upon how many different stockholders there are and in how many different countries they surrender their stock. The provisions of Section 119 are concerned with actual source, not artificialities, and the Regulations give effect to that fact. See Treasury Regulations 94, Articles 119–1 to 119–14, inclusive, especially Article 119–1 (Appendix, *infra*, p. 28).

It is therefore not material here whether the gain taxpayer realized from the liquidation of Hay, Ltd. be deemed a gain from a sale or a dividend.[4] In either event its source was in the

[4] The court below stated that it could not "conclude that a distribution in liquidation may not be treated as a dividend derived from sources in the United States under § 119 (a) (2)" (R. 382). Contrary to taxpayer's assertions (Pet. 12–13, 18), this conclusion does not mean that Sections 143 (b) and 211 (a) must be interpreted as making all nonresident aliens not engaged in trade or business in this country taxable on liquidating dividends and the withholding at source provisions applicable to them. Section 143 (b) requires the withholding at source of dividends, etc., "or other fixed or determinable annual or periodical gains, profits, and income" of nonresident alien individuals. Under Section 211 (a), nonresident aliens not engaged in trade or business in the United States are taxed only on such income. The court below was not concerned with the interpretation of

United States. Cf. *Georday Enterprises* v. *Commissioner,* 126 F. 2d 384, 390 (C. C. A. 4th). And, if it be thought that neither the dividend nor sale of personal property provisions of Section 119 apply, it is uncontrovertible that the source of the gain was in fact in the United States, and that the taxpayer is properly taxable thereon.

2. Taxpayer also states that the issues framed by the pleadings before the Tax Court went only to the question whether he was taxable, under Section 212 (a), on the August, 1937, transaction (*supra,* p. 5); that the Tax Court should have refused to consider the December liquidation of Hay, Ltd.; and that "The framing of issues by written pleadings timely filed is of the essence of fair hearings." (Pet. 15; see also Pet. 16–17.) But, as the opinion below reveals (R. 384), taxpayer was not prejudiced by any deficiency in the pleadings.

Taxpayer's attorneys were notified nearly two months prior to the hearing before the Tax Court that the Commissioner would endeavor to show that, if the August transaction was not taxable, taxpayer received a taxable gain from the December liquidation (R. 140, 165, 196, 201, 274–275). After discussions as to the proper scope of the trial, the trial judge decided that the trial should cover both the August exchange and the December

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these sections, for, as stated, the taxpayer was engaged in trade or business in the United States. Sections 143 (b) and 211 (a) plainly refer to ordinary dividends only, regardless of how the word dividends in Section 119 (a) (2) is interpreted.

liquidation and the hearing proceeded on that basis (R. 152–153). As the court below stated (R. 384):

> It clearly appears from the record that both transactions were examined in detail and that the taxpayer in fact had full opportunity to produce evidence with regard to both transactions.

Here, as in the Tax Court and the Circuit Court of Appeals (R. 384), taxpayer has made no attempt to show that any other testimony relating to the December transaction exists which, if adduced before the Tax Court, might have led to different findings of fact. Hence, there is no substance in taxpayer's complaint as to the pleadings or scope of the trial.

CONCLUSION

The decision below is correct and there is no conflict. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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MARCH 1945.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(3) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock

or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(5) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; * * *.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, * * *.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

* * * * *

(i) *Foreign Corporations.*—In determining the extent to which gain shall be recognized in the case of any of the exchanges (made after the date of the enactment of this Act) described in subsection (b) (3), (4),

(5), or (6), or described in so much of subsection (c) as refers to subsection (b) (3) or (5), or described in subsection (d), a foreign corporation shall not be considered as a corporation unless, prior to such exchange, it has been established to the satisfaction of the Commissioner that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

* * * * *

SEC. 115. DISTRIBUTIONS OF CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

* * * * *

(c) *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117 (a),

100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding two years from the close of the taxable year during which is made the first of the series of distributions under the plan. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subsection (h) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

* * * * *

SEC. 119. INCOME FROM SOURCES WITHIN UNITED STATES.

(a) *Gross Income from Sources in United States.*—The following items of gross income shall be treated as income from sources within the United States:

* * * * *

(2) *Dividends.*—The amount received as dividends—

(A) from a domestic corporation other than a corporation entitled to the benefits of section 251, and other than a corporation less than 20 per centum of whose gross

income is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence), or

* * * * *

(e) *Income from Sources Partly Within and Partly Without United States*—Items of gross income, expenses, losses and deductions, other than those specified in subsections (a) and (c) of this section, shall be allocated or apportioned to sources within or without the United States, under rules and regulations prescribed by the Commissioner with the approval of the Secretary. * * * Gains, profits and income derived from the purchase of personal property within and its sale without the United States or from the purchase of personal property without and its sale within the United States, shall be treated as derived entirely from sources within the country in which sold, except that gains, profits, and income derived from the purchase of personal property within the United States and its sale within a possession of the United States or from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States.

(f) *Definitions.*—As used in this section the words "sale" or "sold" include "exchange" or "exchanged"; and the word

"produced' includes "created", "fabricated", "manufactured", "extracted", "processed", "cured", or "aged."

* * * * *

Supplement H—Nonresident Alien Individuals

SEC. 211. [As amended by Section 501 (a), Revenue Act of 1937, c. 815, 50 Stat. 813.] TAX ON NONRESIDENT ALIEN INDIVIDUALS.

(a)[1] *No United States Business or Office.*—There shall be levied, collected, and paid for each taxable year, in lieu of the tax imposed by sections 11 and 12, upon the amount received, by every nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein, from sources within the United States as interest (except interest on deposits with persons carrying on the banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains,

[1] Section 501, Revenue Act of 1937, c. 815, 50 Stat. 813, added an additional sentence to subsection (a) of Section 211, Revenue Act of 1936, and also further amended Section 211 by adding thereto a new subsection (c). These amendments, enacted on August 26, 1937, were not to apply to "a resident of a contiguous country so long as there is in effect a treaty with such country (ratified prior to the date of the enactment of this Act) under which rates of tax under section 211 (a), prior to its amendment by subsection (a), were ~~resident of a contiguous country so long as there is in effect~~ America and Canada concerning income taxation" was ratified August 13, 1937, 50 Stat. (part 2) 1399 (1939-1 Cum. Bull. 147-148). As a result, the amendments effected by Section 501, Revenue Act of 1937, to Section 211, Revenue Act of 1936, have no application in the present case.

reduced." Such a "Convention betwe
the United States of

profits, and income, a tax of 10 per centum of such amount, except that such rate shall be reduced, in the case of a resident of a contiguous country, to such rate (not less than 5 per centum) as may be provided by treaty with such country. The tax imposed by this subsection shall not apply to any individual if the aggregate amount received during the taxable year from the sources above specified is more than $21,600.

(b) *United States Business or Office.*—A nonresident alien individual engaged in trade or business in the United States or having an office or place of business therein shall be taxable without regard to the provisions of subsection (a). As used in this section, section 119, section 143, section 144, and section 231, the phrase "engaged in trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include the performance of personal services for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of ninety days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. Such phrase does not include the effecting of transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian.

SEC. 212. GROSS INCOME.

(a) *General Rule.*—In the case of nonresident alien individual gross income in-

cludes only the gross income from sources within the United States.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 119–1. *Income from sources within the United States.*— * * *

The taxable income from sources within the United States includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned within the United States.

* * * * *

ART. 119–8. *Sale of personal property.*— Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold, except that income derived from the purchase of personal property within the United States and its sale within a possession of the United States or from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States. The word "sold" includes "exchanged." The "country in which sold" ordinarily means the place where the property is marketed. This article does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States. (See article 119–12.)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.
No. 968

WILLIAM C. HAY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

PETITION FOR REHEARING OF DENIAL OF CERTIORARI.

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To the Honorable Chief Justice of the United States and Associate Justices of the Supreme Court of the United States:

Your petitioner, a British subject, by his counsel, prays for a rehearing with respect to his petition for certiorari, denied March 26, 1945, and respectfully shows:

1. This Court may have been misled by respondent's inexcusably incomplete and distorted paraphrasing of Sections 112(b)(5) and (i).[1] All that petitioner asks

[1]Respondent's Brief in Opposition, pp. 18-19, footnote 4. For basis of petitioner's assertion in this regard, see *infra*, p. 5.

is that Section 112, which draws no distinction between citizens and aliens, be applied to him in the same manner as it would have been applied, on identical facts, to a citizen. Is a friendly alien entitled to less?

2. The decision below conceals as pernicious and subversive a construction of Section 112 as would a decision that respondent has the power to impose a tax on an exchange made by a negro that would unquestionably be tax-free (non-recognized) if made by a white person. It holds in effect that although the August 6 exchange would have been substantial enough, separate enough, and final enough to have *required* respondent to collect a tax of nearly $500,000 thereon if it had been made by a citizen, it was not an "exchange" within Section 112(a) simply because made by a nonresident alien outside the United States. Is this equal justice under law?

3. Respondent admits that a distribution in liquidation is not a "dividend" when the stockholder is a nonresident alien not engaged in business in the United States, but asserts that it is a "dividend" to a nonresident alien who is so engaged. [1a] This is unprincipled policy-making by an administrative official not consonant with fair play.

4. The decision below circumvents the declared policy of Congress not to tax nonresident aliens on income from sources without the United States by ignoring the undisputed finding that the transfers of title in the December exchange took place in Nassau.

[1a] Respondent's Brief in Opposition, note 4, pp. 18-19.

ARGUMENT.

I.

Solely Because Petitioner Is a Nonresident Alien, Respondent Would Ignore the Plain Language of Section 112 and Reverse Settled Principles of Law Applicable to the Exchange of August 6.

On the August 6 branch of the case the crux of respondent's argument appears on page 14 of his brief, as follows:

> * * * Accordingly, whatever the Nassau corporation did must be deemed to have been done by taxpayer. When he exchanged his Hay, Ltd. stock for the Nassau corporation stock, he made an exchange with himself which had no substantive effect; the transaction was a mere formality. The Commissioner was not bound *to assess a tax*[2] on this transaction under Section 112(i) and, in that way, aid in the consummation of taxpayer's plan for tax avoidance which Congress, in Section 112(i) itself, intended to forestall. * * * (Italics supplied.)

Every one of these contentions is the complete opposite of the unquestionably correct principles that would have *required* the Commissioner to assess a tax on the August 6 exchange if petitioner had been a citizen, and which would have prevented the Commissioner from taxing a citizen on the December liquidation.

If a citizen had made the exchange of August 6, both the letter and policy of Sections 112(a) and (i) would

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[2]Section 112(i) does not "assess a tax"; it goes only to the matter of *recognition* of gains. Other sections, including Section 212(a), determine whether a tax is assessed in a particular case.

have *required* the Commissioner to treat the Nassau corporation as a separate entity, and not as an agent of its sole stockholder.[3] Congress, in enacting these statutory provisions, drew no distinction between citizens and nonresident aliens.[4] Is it fair play for an administrative official to draw a distinction based *solely* on petitioner's being a nonresident alien? Is it fair play to treat a foreign corporation as the agent of an alien when the same corporation, in identical circumstances, would not be treated as the agent of a citizen?

Is it fair play for the Commissioner to say that an exchange with a valid foreign corporation is a "mere formality" without "substantive effect" *solely* because made by a nonresident alien, when it is indisputable that a citizen, in identical circumstances, would have realized a "recognized" gain on which the Commissioner unquestionably would have been "bound to assess a tax"?

Is it fair play for the Commissioner to contend that the August 6 exchange was "interlocutory"[5] solely because made by a nonresident alien *outside* the United States, when it clearly would have been treated *by the statute* as

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[3]This Court rejected the agency argument in *Moline Properties, Inc. v. Commissioner,* 319 U. S. 436, erroneously decided by the same judge of the Tax Court who decided the case at bar.

[4]Compare, by analogy, *Gcorday Enterprises v. Commissioner,* 126 F. (2d) 384, at 389 (C. C. A. 4, 1942) and *Capital Estates, Inc. v. Commissioner,* 138 F. (2d) 156, at 157 (C. C. A. 3, 1943).

[5]Respondent's Brief, p. 10, last line.

"isolated"[6] and final if made by a citizen—or if made by petitioner *within* the United States.[7]

Is it fair play for the Commissioner to distort the true meaning of Section 112 by an inexcusably erroneous paraphrasing (Respondent's Brief, p. 12, note 1) of Sections 112(b)(5) and (i)—a paraphrasing which *omits* the words "or loss" which appear in Section 112(b) (5) and which neglects to inform this Court that Section 112(i) operates to *withdraw* nonrecognition only of *gains*, while *preserving* nonrecognition of *losses*? ("Withdraws" is the word used in the committee reports explaining the purpose and effect of Section 112(k) of the Revenue Act of 1932, the precursor of Section 112(i) of the Act of 1936.[8]) A reading of Sections 112(a), (b) (5), and (i) together shows that the congressional purpose of Section 112(i) can be achieved *only* by treating a *foreign* corporation as a separate entity under Section 112(a)[9] and by treating *each* exchange (where there are two or more) as an "isolated" and final transaction. Only by treating each exchange as *separate* can the nonrecognition of *loss* be preserved.

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[6]Respondent's Brief, p. 13, 12th line from bottom.

[7]If the property which petitioner exchanged on August 6 had been "real property located in the United States" the gain would not only have been "recognized" because of Sections 112(a) and (i) but would have been taxable as gross income of a nonresident alien because attributed by Section 119(a)(5) to "sources *within* the United States." Compare *Texas-Canadian Oil Corp.*, 44 B. T. A. 913 (1941).

[8]See Appendix to Petition herein, pp. 27-29, reprinting the relevant portion of Sen. Rep. No. 665, 72nd Cong., 1st Sess., 1939-1 Cum. Bull. (Part 2), p. 515.

[9]Otherwise, as Mertens points out, there could never be a taxable transaction; see Law of Federal Income Taxation, Mertens, Vol. 3, §20.13 at page 117.

In *Texas-Canadian Oil Corp.*, 44 B. T. A. 913 (1941),[10] the Commissioner persuaded the Tax Court that Section 112 "can not be ignored" (p. 919) for any reason. That decision is unquestionably correct.[11] The gain there was from the exchange of "*real* property located in the United States" and therefore, under Section 119(a) (5), was "treated as income from sources within the United States" even though the exchange "was consummated outside the United States." (p. 919) The gain would have been non-recognized except for Section 112(i).

Section 112(i) is not limited to transfers of *real* property to a foreign corporation. Is it fair play to say that gain on transfers of United States *real* property will be "recognized" in all cases, but that gain on transfers of *personal* property will not be "recognized" where they are made by a nonresident alien outside the United States? Is it fair play for the judiciary to read Section 112 with one eye on Section 212(a)—to say that a transaction is not an "exchange" within Section 112(a) if it gave rise to gain excluded from an alien's gross income by Section 212(a)?

The *Texas-Canadian* case is the only reported decision directly involving Section 112(i). It was called to the attention of both courts below. They chose to treat it as non-existent. Respondent has never attempted to distinguish it. It is impossible to give effect to that decision

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[10]The taxpayer's appeal to C. C. A. 5 was dismissed November 20, 1942, 424 C. C. H. p. 1071, 30 A. F. T. R. 1735.

[11]Mertens says of the *Texas -Canadian* case that "In view of the sweeping language of the section [112(i)], no other conclusion seems warranted." Law of Federal Income Taxation, Mertens, Vol. 3, p. 116, note 7.

and sustain the tax here involved. It would be impossible to collect a tax from a citizen if Section 112(i) were ignored.

Respondent erroneously asserts[12] that "The plan executed by taxpayer was one predicated principally upon Sections 112(i) and 119(e) * * *." This assertion, so far as it relates to Section 112(i), is without warrant in the record. If Section 112(i) had never been enacted, petitioner would nevertheless have realized a gain on August 6 under Section 112(a). Since that exchange was consummated outside the United States, the gain, whether "recognized" or not, was excluded from petitioner's gross income by Section 212(a). When a nonresident alien brings a transaction within Section 212(a), that is the type of tax avoidance contemplated by that provision, not the type condemned by the principles of cases like *Gregory v. Helvering*, 293 U. S. 465, and *Higgins v. Smith*, 308 U. S. 473, upon which respondent relies. This is shown by the facts and opinion in a latter decided case, *Elston Co., Ltd.*, 42 B. T. A. 208 (June, 1940), in which profits on *several* sales of securities by a foreign corporation were held taxable to the extent consummated *within* the United States but free from tax where the sales were made *outside* the United States.[13]

In *Higgins v. Smith*, 308 U. S. 473, this Court said (p. 477):

> * * * The Government * * * may sustain or disregard the effect of the fiction as best serves the

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[12]Respondent's Brief, p. 12, 14th line.

[13]The Commissioner's appeal in the *Elston* case was dismissed by the Fourth Circuit Feb. 3, 1941. C. C. H. 1945 Index Volume, p. 19,414.

> purposes of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation. * * *

May the Commissioner "sustain or disregard" depending on whether the sole stockholder is a citizen or an alien? May the Commissioner "supersede legislation" such as Section 112(i), which is bottomed on recognizing, not disregarding, the separate entity of a foreign corporation in exchanges resulting in gains? Obviously the Commissioner could not, and would not, "disregard" the Nassau corporation if the recipient of its shares on August 6 were a citizen. His wish to do so here (while inconsistently seeking to take advantage of what that corporation actually did in December)[14] springs *solely* from the *existence and applicability* of Section 212(a). Thus, it is the Commissioner, not the taxpayer, who would "supersede legislation" here.

How can any court, in justice, disregard a substantial, valid and permanent corporation, created for legitimate purposes[14a] by an alien under the laws of his own sovereign, when it is construing a statute that would *compel* recognition of the same corporation, whatever its purposes, if petitioner had been a citizen?

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[14]Petitioner's Nassau corporation owned assets worth over $2,500,000 for over four months before it liquidated Hay, Ltd. and, as the undisputed findings show, still owned all these assets five years later.

[14a]The undisputed finding is that "Colonial Trust Co., Ltd., was incorporated for the primary purpose of removing the situs of petitioner's wealth from the United States with a view to avoiding estate taxes in the United States. * * *." [R. 61-62.]

II.

Respondent's Brief and the Decision Below Ignores Decisions of This Court Holding That a Distribution in Liquidation Is Not a Dividend.

Even if the August 6 gain, taxable to a citizen, is ignored here, respondent can not win unless the December 10 liquidation was a "dividend" within Section 119(a)(2). Because of this, respondent's brief[15] makes the following astounding assertion:

> * * * But although liquidating dividends, to the extent that they are distributions of earnings and profits accumulated after February 28, 1913, come within the definition of a "dividend" contained in Section 115(a) * * *

In *Helvering v. Credit Alliance Corp.*, 316 U. S. 107 at 110, this Court said:

> * * * a distribution in liquidation *of earnings* * * * does not constitute a dividend in the proper sense of the term, * * *. (Italics supplied.)

It required a *special* statutory provision to permit the Credit Alliance Corporation to treat the liquidation distribution "as a taxable dividend paid" because it was not a "dividend" to the stockholder-distributee. A distribution is not a "dividend" unless made by a *going* corporation "in the ordinary course of business." *Hellmich v. Hellman*, 276 U. S. 233, 237. The Treasury has profited greatly by the "exchange" concept of a distribution in liquidation. See *Canal-Commercial Trust & Savings Bank v. Commissioner*, 63 F. (2d) 619, certiorari denied, 290 U. S. 628, and *Texas-Empire Pipe Line Co. v. Commissioner*, 42 B. T. A. 368, reversed on another point, 127 F. (2d) 220.

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[15]Respondent's Brief, p. 16, lines 6 to 10.

Why should the statutory—and realistic—"exchange" concept be abandoned in favor of the "dividend" concept when the Commissioner rightly concedes that he can not treat a distribution in liquidation as a "dividend" in taxing nonresident aliens not engaged in business in the United States?

III.

The Decision Below Ignores the Settled Rule That Profit on a Sale or Exchange of Personal Property Is Made Where the Final Act Making the Transfer Effective Takes Place.

On December 10, 1937, Hay, Ltd. was present in Nassau, represented by its directors and officers, residents of that place. The Nassau corporation at that place exchanged the shares for the assets. Under California law the exchange took place in Nassau. *Balconades Ballroom, Inc. v. Superior Court*, 109 Cal. App. 612, 615.

If, as respondent asserts, a distribution in liquidation is a unilateral act, it was in this case, as the undisputed findings show, the act of the Nassau corporation; that corporation, as the stockholder, brought about the liquidation. But the real answer is that Congress has seen fit to treat the stockholder as giving up his shares in "exchange" for assets. The question is where did the stockholder transfer the title to his shares, not where did the corporation get the assets which it distributed.

That the "profit" on a sale (or its exact equivalent in tax law, an exchange) of personal property is made where the final act making the transaction effective takes place, is familiar law in this Court. *Compania General de Tabacos v. Collector*, 279 U. S. 306, 309. The "profit" on

the December 10 exchange was made in Nassau. Not being from a source within the United States, it could not be taxed to a nonresident alien without giving the revenue laws an extraterritorial effect in defiance of the expressed will of Congress, which, conscious of the country's international obligations, sought—ineffectually in this case—to place its fiscal agencies under a decent restraint.

Conclusion.

The importance and nature of the matters involved would seem to justify asking this Court to investigate whether the purpose and intent of the revenue laws have been subverted in fundamental respects and in a manner to deprive an alien of the basic concepts of fair play.

It is submitted that the order of March 26, 1945, should be vacated and that the petition should be granted.

Respectfully submitted,

JOSEPH D. BRADY,
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WALTER L. NOSSAMAN,
Of Counsel.

April 12, 1945.

Certificate of Counsel.

The undersigned counsel of record hereby certifies that the foregoing petition is presented in good faith and not for delay.

JOSEPH D. BRADY,
Attorney for Petitioner.

Service of the within and receipt of a copy thereof is hereby admitted this.....day of April, A. D. 1945.

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